City of Lincoln Nebraska
Police and Fire Pension
Summary for 11/05/98 Advisory Committee Meeting

Members Present: Dennis Duckworth, Alan Townsend, Al McCray, Don Mathes, Aaron Drake, Jim George.
Members Absent: None
City Staff: John Cripe, Paul Lutomski
Others: Mike Morosin

Dennis Duckworth: Meeting is called to order. Motion to approve the August minutes?

Al McCray: So moved.

Alan Townsend: Second.

Dennis Duckworth: All in favor?

Dennis Duckworth, Alan Townsend, Al McCray, Aaron Drake, Jim George: Aye.

Dennis Duckworth: Opposed? (silent) Motion carries. Introduces new members Alan Townsend and Don Mathes. Recent activities John?

John Cripe: We had talked about some improvements in the computer system. A list of implemented changes starts on page 8.

We have summarized the data sent to our actuary on pages 16 - 19.

Pages 20 to 26 is our budget request. As background for new members, we have been funded very well. We use our excess dollars to offset taxpayer contributions. We projected overfunding to be zero in 5 years at the $400,000 rate of city contribution. The Council approved doubling the City's contribution to $800,000. I have asked for an additional $200,000 increase for each of the next five years. That request is reprinted for you.

Letter "F" pages 27-38 is the monthly interest ordinance. It looks like this will be approved. I mentioned last time that this change will affect pension estimates. We have a computer program that estimates pension benefits for any future date for any member. To estimate pension benefits we must forecast both salary and account values. Salary increases are set to default at 3%, but anywhere from 0% to 6% can be used as the employee wishes. Interest rate is not variable. It is either our 7% assumed rate, or the actual rate in arrears. To explain: For any given calendar year we know exactly what we will be crediting since the rate is credited in arrears. For example, in 1997 the pension earned 14.82%. This rate is credited to the members account balance as of January 1, 1998. So, if a member comes in on February 1, 1998 and wants an estimate for November 10, 1998 we apply the 14.82% against their 1/1/98 account balance to calculate their interest of say $50,000. If that same member comes in again on June 1, 1998 and wants an estimate for November 10, 1998 we again apply the 14.82% against their 1/1/98 account balance to calculate the exact same interest amount as before, $50,000.

Once the monthly interest crediting takes effect, the interest amount for a November 10, 1998 retirement date estimated on February 1, 1998 would be different from a November 10, 1998 retirement date estimated on June 1, 1998. The difference would come from the fact that we are basing our interest calculation on different starting points. Using annual crediting the starting point was always January 1, 1998. Using monthly crediting the starting point would be the end of the last completed month, in this case January 31, 1998 and May 30, 1998. Also, rather than begin to use a 7% interest rate after a calendar year break, we would begin to use a 7% interest rate after a month break. (because we are calculating interest monthly now rather than annually).

As it stands now, the interest crediting method is only significant for those members leaving before 10 years of service. For vested 7% and 7.6% members taking a refund, the monthly pension amount is adjusted. If their account value is higher, their monthly pension is lower and vis-versa. For vested 8% members the method of crediting interest doesn't matter.

Item "G." We had discussions with both Police and Fire Union Presidents with regard to a DROP program. A memo sent to them is copied on pages 39-41. I'll give a description of the plan. DROP is an acronym for Deferred Retirement Option Plan. It has been put in place around the country. After reaching eligibility an employee could retire on paper, but not in fact. Using the 8% plan as an example: full retirement is a 64% payout at age 50 and 25 years of service. Aaron gets to be age 50, doesn't want to quit working, but does want to stockpile some dollars for retirement. He could enter the DROP program and give an effective retirement date of age 53. We would pay his monthly pension benefit into a trust account for him and it would accumulate interest. At age 53 he would retire and we would pay the monthly benefit to him and he would have a pool of dollars from the DROP to enhance his retirement. The downside is that Aaron retires at age 50 for pension purposes. Anything that happens to him from age 50 to 53, such as wage increases, disability or death, would not affect his pension. The positive side is that he could end up with $100,000 cash plus a full 64% pension for retirement. The program has been real successful in law enforcement and fire fighting throughout the country. Discussion?

Jim George: How does it affect the 7.6% pension?

John Cripe: You would leave your contributions and interest. Eligibility is age 53 and 21 years of service for a 58% pension.

Jim George: Then you would lose the extra 2% per year.

John Cripe: Yes. Taking the DROP at that age would not make sense. Retirement at age 50 and 21 years would be a better example. In this instance, you could retire at age 53 with a full monthly pension and a DROP lump sum roughly equal to the lump sum you would have received. The DROP was designed for the 8% plan, but we would let the 7% and 7.6% members participate.

Jim George: This would be each individual's option?

John Cripe: Absolutely. One of the biggest questions is whether to self direct or not. Some plans are self directed, others give a guaranteed rate, like 1% less than the pension assumption. If self directed we would pay the chosen vendor, and there would have to be an agreement that you could not withdraw the money before your retirement. We would also want to design the DROP so it is revenue and cost neutral. Once the parameters are finalized we would ask our actuary, Gabriel Roeder Smith, to cost the plan out. We are not trying to create additional pension liability and we are not trying to make money. We are trying to provide a benefit that is good for you all. We would like to have baseline language and costing done for a presentation at our February meeting. Then we would discuss this with the interim Mayor and Council.

Al McCray: Does this require a three year retirement notice?

John Cripe: You could retire within the three years. We think an average pension could accumulate about $100,000.

Al McCray: Is this new? Have they had any problems with poor performance when assets were self-directed?

John Cripe: It has been put in place around the country for some time. I don't know about problems with poor performance when assets were self-directed. I'd be inclined to offer self directed.

Al McCray: No legal ramifications for losses incurred?

John Cripe: None.

Aaron Drake: I've done considerable research on DROP plans around the country. There are a tremendous amount of variables. Variable I've seen are years in the plan. They range from 2, to unlimited years. Another variable is whether the COLAs are contributed to the plan. What variables are we looking at?

John Cripe: The desire of the 8% plan was to point toward age 50 as a retirement age, due to the increased risk to the employee of a duty or non-duty disability. Entering the DROP at age 50 gets us to age 53, the normal retirement age of the other plans. The other plan's member's can participate in the DROP at age 50 and 21 years. Additionally, Dallas Texas told us their 5 years was too long. People ended up leaving closer to three years into the plan. The people saw their dollars accumulating and wanted out. Keep in mind the majority of pension plans throughout the country will not let you take a refund of your contributions and interest. They pay a monthly annuity and that's it. This is pretty attractive to most of the people in those plans. The 7% and 7.6% get a lump sum refund now, with a reduced annuity. The 8% plan is much like all the others in the country. If an 8% member entered the DROP program they would no longer contribute the 8%. We kind of tailored the DROP plan for the 8% plan members. It doesn't mean we are not interested in suggestions. We weren't anticipating a major re-write of the plan ordinances. We planned doing this in the context of the existing plans.

Paul Lutomski: What about the COLA being paid into the DROP plan?

John Cripe: The context of the existing plans allows the COLA to be paid after the member receives a year of benefits. I would have no problem paying the COLA into the DROP.

Dennis Duckworth: Could the entry parameters be changed to allow those members already above the entry parameter to enter the DROP plan.

John Cripe: We could try to allow for some grandfathering for those folks. Police has very few people this would affect. Fire has about 30 people.

Jim George: We have a lot of people above minimum retirement eligibility. They tend to want to stay longer than Police.

John Cripe: Frankly, we don't want to get into a position where an employee can't perform his duties safely, but refuses to retire. We have to make a decision as a group what is best for everyone. Police and Fire are physical jobs and the safety of one member depends on the abilities of the others.

Jim George: Rather than use age as a guideline it should be fitness for duty.

John Cripe: We had an agreement on a fitness for duty testing system but then ended up in court, and the fitness for duty did not get repeated in the latest contract.

Paul Lutomski: Jim, the DROP would address your concern for the fire fighter that wants to stay longer. An 8% member could enter the DROP at age 50 and 25 years of service, stay three more years and get a lump sum of about $100,000 from the DROP. They would also have stopped paying the 8%, so they could save that also.

John Cripe: This can be a huge benefit for almost anyone, no matter which plan they are in. This plan can help accomplish some dream things, like a cabin or a car, that some people have, but it also preserves the basic economics of their pension. It is a personal decision, whether the DROP is something that fits with the employee's retirement goals.

Aaron Drake: One of the advantages of the 7% and 7.6% plans is the lump-sum refund. If they wanted to go into the DROP they would lose that. What about considering the employee's lump sum be paid into the account and the reduced monthly check then be paid into the DROP? That would give them the ability to maintain the benefit they have and take advantage of the DROP.

John Cripe: We have not seen that done in a DROP.

Aaron Drake: I understand, but it would be possible to do it.

Paul Lutomski: I have a concern we would be treading on new ground. Do other plans have a lump sum refund option they then allow to be paid into their DROP? I wouldn't want to screw up everybody's taxes.

John Cripe: We've been in some messes that sounded pretty good at the beginning. Refunding pre-21 contributions comes to mind. Two or three years after the checks were written the IRS gives us an answer that caused a lot of problems.

Paul Lutomski: We know the way the DROP has been described here today, has worked at several other places for many years. We know that to trustee transfer a lump sum it must be transferred to another tax qualified plan. Does a DROP qualify?

Aaron Drake: How is one distribution different from another distribution?

Paul Lutomski: We should ask the IRS or a tax expert.

Dennis Duckworth: Has there been any discussion of allowing the 7% and 7.6% people to bump up to the 8% plan?

John Cripe: Yes, but we haven't explored the economics of it. The people that switched have been paying 8% since 1995. People in the other plans have been contributing 7%, or 7.6%, or nothing. We haven't asked the actuary to cost it out. We have a request for them to cost out increasing the 64% to 66%. Despite what most folks think we are always looking at the benefit structure and trying to think of ways to improve it without increasing our overall cost. We are looking right now at the prospect of raising retiree monthly benefits. We could use some of our COLA pool to pay for it. It's hard to go the City Council and ask for more contribution and at the same time ask for a benefit increase. If given a formal request by this group we could investigate the economics and if 7% and 7.6% people would have to buy into the 8% plan by writing us a check for the difference in contribution rate plus interest. If they have to buy back in, we probably wouldn't care and could offer another switch to the 8%. If there were no buy back, there would be a cost and it would be hard to ask for increased city contributions while increasing the cost due to the switch.

Paul Lutomski: I don't see how we could not make employees buy back the contribution difference and interest. It would hurt all the people that switched in 1995 and have been paying 8% contributions since then.

Dennis Duckworth: It would absolutely not hurt them a bit. It would make them feel bad, but it wouldn't hurt them.

Paul Lutomski: Okay, but if I switched in 1995 and you switched now, I would have been paying 8% since then and you would been paying 8% since now. I would have paid more for the same 64% benefit. I understand what you are saying, but I wouldn't want the pension to cause dissention among the ranks.

John Cripe: If two people were making $30,000 and one switched to the 8% plan three years ago and the other just switched and now they are both retired, the one that switched three years ago would have paid more to get their 64% pension.

Dennis Duckworth: Okay. I have another question regarding health insurance. The City changed it's health insurance. Our pensioners' didn't do anything, but now it's costing them a lot more money. If we're looking at increasing benefits for those people I'm all for it.

John Cripe: The pension doesn't have any control over health care. When it came time to switch to a new provider the bulk of people got a better value. We went in asking what was going to happen to our folks and they hadn't spent much effort for those people. Blue Cross had carried people over age 65 on sort of an extra plan that was not part of any regular program. At the end, when Blue Cross went away, angrily, they did not maintain that plan. Those folks had to go to a Medicare supplemental policy. If this group would approve going forward, we would certainly investigate increasing monthly benefits for retirees and paying for the cost from the COLA pool.

Paul Lutomski: In 1992 when we did this, we increased by 1/2% for each year of retirement. This time we are looking at increasing by 1% for each year of retirement.

John Cripe: We have some stragglers. I'm one of them. The point is that some folks are on a deferred payment for 15 or 20 years, and the payment was not adjusted. About 50 to 80 people. You might want to consider making an adjustment there, or getting to a minimum payment. It's not very expensive. If the new minimum is $500, we will have some people coming off the deferred roles and they had never received an adjustment. Their payments would have been $200 or $300. These are the kinds of issues we were looking at. We'd like some direction so we can go forward.

Aaron Drake: I'd like to go forward, but I have some issues I'd like to have clarified.

John Cripe: We could allow a couple of weeks for you to give us a list of issues. Keep in mind that the DROP was designed around the 8% plan.

Paul Lutomski: I have been making some notes. There are three possible motions. One is to develop a plan to allow people the opportunity to switch from the 7% and 7.6% plans to the 8% plan. Two is develop a plan to increase retiree monthly benefits and the COLA to be paid from the COLA pool. Third is implementation of the DROP plan.

John Cripe: All three could be made in one motion.

Alan Townsend: I make a motion to move forward on those three items.

Aaron Drake: Second.

Dennis Duckworth: Discussion?

Alan Townsend: We should set a timeline.

John Cripe: In a couple of weeks we would like to have a written list of each group's concerns regarding the DROP and the two other issues.

Dennis Duckworth: All in favor?

All: Aye (Don Mathes' abstained)

Dennis Duckworth Motion carries.

John Cripe: Item H. Transactions. August 15th a strip matured for $145,000 and we used the funds to pay our 13th check COLA. It went smoothly except for one person who did not get a check. He called and we paid him. Hopefully, we won't omit anyone next year.

Item I. We purchased a strip. $6 million maturity for 2017. It was a little lower yield than we like. We brought a copy of our investment policy for everyone, mostly for the new members. I don't know if the policy will change, if so it probably won't be until next summer when we have a new mayor.

Item J. Paul has been working to convert from CAPTOOLs DOS to CAPTOOLs for Windows. We asked for an increase in the size of his hard drive. Later we found it made better sense to get a new computer. A new computer cost about $100 more than a bigger hard drive when labor is included. Data processing changes $45 an hour for labor.

Item K. Page 44 is our balance sheet. Page 42 and 43 is a report from CAPTOOL.

Paul Lutomski: Last meeting I mentioned giving the committee a sample CAPTOOL report, so this time I was able to get enough done to print this report.

Aaron Drake: This would be nice in color.

John Cripe: We have a color printer coming. As you can see the shades of gray are difficult to differentiate. Next quarter we'll have color graphs. We're in great shape. Market value as of September 30th was $130 million. For the new members, Paul and I do the investments per policy and this committee's discussions. Somewhere in 1995 we sold most of our pre year 2000 bonds and put them in longer term strips that have performed very well and are very valuable now. We do not have any money to invest until September 1999. This is a great position to be in, given today's market. If we increase our equity position we would sell some bonds and dollar cost average into equities. You each have a copy of our investment policy. If you have any suggestions for change you can mention them at the next meeting. It has been a pretty good tool. Page 45 - 47 is our cash flow estimate. We do not have any money to invest until September 1999. Page 48 is a non-color maturity distribution chart. Page 49 - 52 is a 10 year cash flow estimate. We are sort of nervous about the $11 million 2001 investment.

Don Mathes: Are your maturities constructed to cover cash needs?

John Cripe: Yes.

Paul Lutomski: Mostly we are using semi-annual bond interest, monthly CMO interest, City and employee contributions, to pay our monthly benefits.

John Cripe: The refund feature of the 7% and 7.6% plan make it hard to plan ahead regarding cash. We have 4 people planning to leave in January and they will be most likely be taking a refund. We hate to have to sell something to make those payments.

Don Mathes: Most everything is pretty marketable isn't it?

John Cripe: Yes. Everything is very good.

Don Mathes: It appears you have had advice to extend maturities? Where is that advice from?

John Cripe: We have been extending for the last four or five years. When we took over the plan it was ladderred and we have maintained that. In 1994, 1995 the committee allowed us to swap and extend our maturities for interest rates.

Paul Lutomski: Since about 1991, we have bought fairly long term treasury strips almost every time we have money to invest. Early on, coupon interest paid all the monthly benefits and more. This was based upon economists' reports expecting a declining interest rate scenario. It has worked out well. We have locked in high yields on strips while the interest rate has declined. What will happen from now on is a question.

John Cripe: We wanted to lock in rates greater than our 7% assumption rate. We have very few that are earning less. Now that you are on the committee you can help us.

Don Mathes: I was interested in the decision making process. If there was a time when interest rates were going the other way how would that be considered.

John Cripe: That was a real consideration when we bought CMOs for the first time. We bought CMOs that were expected to begin principal payments in 10 years and they started to pay in 7 or 8 months. So we sold them and purchased a different instrument. The gains were 28% to 30% over a short time. We were buying top quality stuff and it really paid off for us. That market is very stable today. We watch the market, but are not aggressive buyers or sellers. About three weeks ago, when rates were so low, Paul worked with some brokers to analyze our portfolio to see if it made sense to sell something. They could not find anything they thought would improve our portfolio above what we already had. We think we're in pretty good shape. Anything else?

Dennis Duckworth: Any other business? If not I'll entertain a motion to adjourn.

Jim George: I'll make a motion to adjourn.

Aaron Drake: Second.

Dennis Duckworth: All in favor?

All: Aye.

Dennis Duckworth: Meeting adjourned.